

Message Text

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ACTION EUR-12

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TO SECSTATE WASH DC PRIORITY 6499

AMEMBASSY BONN PRIORITY

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E.O. 11652: N/A

TAGS: ECON, OECD

SUBJECT: EDRC ANNUAL REVIEW OF GERMANY, APRIL 16

REF: OECD DOCUMENT EDR(75)8

1. SUMMARY: SECRETARIAT DOCUMENT EXPRESSES CONSIDERABLE DOUBT THAT PRESENT LEVEL OF FISCAL AND MONETARY STIMULUS WILL BE SUFFICIENT TO CREATE SUSTAINABLE RECOVERY GIVEN ABSENCE OF EXPORT BUOYANCY AND STRUCTURAL WEAKNESS OF HOUSING MARKET. WITH OUTPUT EXPECTED TO GROW ONLY 1 PERCENT IN 1975 (VERSUS GERMAN FORECAST OF 2 PERCENT), SECRETARIAT SEES LITTLE PROSPECT FOR MARKED IMPROVEMENT IN EMPLOYMENT SITUATION OR FOR STRONG BUSINESS INVESTMENT UPSWING. SECRETARIAT AGREES WITH GERMAN FORECAST OF ABOUT 6 PERCENT INCREASE IN PRICES, AND EXPECTS CURRENT ACCOUNT BALANCE TO BE SLIGHTLY LARGER THAN RECORD LEVELS OF 1974. MAIN ISSUES FOR DISCUSSION AT ANNUAL REVIEW WILL BE SHORT-TERM PROSPECTS (E.G. TIME PROFILE OF RECOVERY) AND POLICY OUTLOOK, AND MEDIUM-TERM TENDENCIES OF EXTERNAL AND INTERNAL FINANCIAL BALANCES. ACTION REQUESTED: SINCE U.S. WILL BE EXAMINER OF GERMANY, WE WOULD APPRECIATE QUESTIONS OR COMMENTS IN TIME FOR ANNUAL REVIEW. END SUMMARY.

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2. OUTLOOK FOR GROWTH AND DEMAND: SECRETARIAT DOUBTS THAT UPSWING EXPECTED BY GERMAN AUTHORITIES WILL MATERIALIZE UNDER PRESENT POLICY ASSUMPTIONS. MAIN REASON FOR PESSIMISM IS WEAK OUTLOOK FOR EXPORT GROWTH WHICH IN PAST HAS LED ECONOMY OUT OF RECESSION. ALSO THERE SEEMS TO BE LITTLE PROSPECT OF REVERSAL OF DOWN-TREND IN RESIDENTIAL CONSTRUCTION WITH PRESENT SURPLUS OF HOUSING STOCK. SECRETARIAT SEES LITTLE LIKELIHOOD OF PICKUP IN BUSINESS FIXED INVESTMENT IN VIEW OF LARGE MARGINS OF UNUSED CAPACITY AND WEAK EXPORT DEMAND. RECENT INVOLUNTARY BUILDUP OF INVENTORIES WILL LEAD TO DOWNWARD ADJUSTMENT IN EARLY 1975 AND ONLY MODEST RECOVERY IN STOCKBUILDING LATER IN YEAR AS DEMAND INCREASES. MOST IMPORTANT EXPANSIONARY FACTOR IS LIKELY TO BE PRIVATE CONSUMPTION, ASSUMING MODERATE IMPROVEMENT IN EMPLOYMENT OUTLOOK LEADS TO DECLINE IN PERSONAL SAVINGS RATION. SECRETARIAT DOES NOT SEE MUCH PICKUP IN FIRST HALF OF YEAR, AS STIMULUS FROM TAX REFORM WILL HAVE ONLY GRADUAL IMPACT ON DEMAND. SOME ACCELERATION OF GROWTH OF AGGREGATE DEMAND MAY OCCUR IN SECOND HALF AS FIRMS BEGIN TO REBUILD INVENTORIES, BUT IN SECRETARIAT VIEW IT IS UNLIKELY THAT EXPANSION WILL EXCEED RATE OF GROWTH OF CAPACITY.

3. EMPLOYMENT OUTLOOK: WITH LARGE MARGIN OF SLACK CONTINUING THROUGHOUT YEAR, SECRETARIAT EXPECTS THAT AVERAGE UNEMPLOYMENT RATE IN 1975 WILL BE ABOUT 3.5 PERCENT, OR 800,000 UNEMPLOYED. THIS ASSUMES NET DECREASE IN AVERAGE FOREIGN LABOR FORCE OF 235,000 DURING YEAR.

4. POLICY RECOMMENDATIONS: SECRETARIAT FULLY APPROVES OF RECENT EXPANSIONARY SHIFT OF DEMAND MANAGEMENT POLICIES, IN VIEW OF FALLING PRODUCTION, RISING UNEMPLOYMENT, DECLINING FIXED ASSET FORMATION AND DRAMATIC INCREASE IN CURRENT EXTERNAL SURPLUS. SECRETARIAT IS CONCERNED THAT PRESENT LEVEL OF STIMULUS MAY BE INADEQUATE TO BRING ABOUT SUSTAINABLE RECOVERY, AND IT SEES POSSIBILITY THAT FURTHER DETERIORATION OF EMPLOYMENT CONDITIONS COULD PRODUCE STRONG PRESSURES FOR REFLATIONARY MEASURES, WITH CONSEQUENT RISK OF REKINDLING INFLATION. SECRETARIAT LIMITED OFFICIAL USE

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ALSO EMPHASIZES DESIRABILITY OF LARGE COUNTRIES IN STRONG EXTERNAL POSITIONS TAKING LEAD IN EXPANDING THEIR ECONOMIES, IN ORDER TO RELIEVE PRESSURE ON COUNTRIES WHOSE HIGHER INFLATION RATES AND BALANCE OF PAYMENTS DEFICITS PREVENT THEM FROM RELAXING DEMAND RESTRAINTS.

5. POLICY MEASURES: SECRETARIAT URGES GERMAN AUTHORITIES TO BE PREPARED TO ACT QUICKLY IF BY MID-YEAR THERE IS

STILL NO SIGN OF EXPECTED RECOVERY. IT RECOMMENDS (A)
USE OF CONTINGENCY GOVERNMENT SPENDING PROGRAMS WHERE
THEY CAN BE QUICKLY IMPLEMENTED, OR (B) CUTS IN VAT RATE
TO STIMULATE DEMAND AND REDUCE PRICES. SECRETARIAT DOES
NOT CONSIDER INCREASE IN BUDGET DEFICIT TO BE MATTER OF

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MAJOR CONCERN, IN VIEW OF HIGH LEVEL OF PRIVATE SAVINGS
AND WEAK DEMAND FOR INVESTMENT FUNDS. ALSO, CURRENT LOW
LEVELS OF ECONOMIC ACTIVITY MEAN LOWER TAX REVENUES AND
HIGHER TRANSFER PAYMENTS, WHICH WOULD BE REVERSED IF
FISCAL POLICY MEASURES WERE TO SPARK RECOVERY. ON
MONETARY SIDE, SECRETARIAT THINKS THAT 8 PERCENT GOAL
FOR GROWTH OF MONETARY BASE IS PROBABLY COMPATIBLE WITH
OFFICIAL OUTPUT GROWTH TARGETS, BUT SHOULD NOT IN ANY
CASE BE ALLOWED TO CONSTITUTE A CONSTRAINT ON THESE
TARGETS. THERE IS SOME DOUBT WHETHER STRICT ADHERENCE
TO 8 PERCENT TARGET MAY INDUCE UNDESIRABLE RISE IN
INTEREST RATES.

6. U.S. WILL BE ONE OF TWO EXAMINERS OF GERMANY
(OTHER IS ITALY) AT ANNUAL REVIEW. WE SHALL BE PARTI-

CULARLY INTERESTED IN GERMAN RESPONSES TO QUESTIONS IN
MAIN ISSUES PAPER ON POSSIBLE LIMITATIONS ON FISCAL
POLICY IMPLICIT IN RISING PUBLIC SECTOR DEFICITS, AND ON
SECRETARIAT PROPOSAL THAT DECLINE IN FOREIGN SURPLUS
WILL REQUIRE DETERIORATION IN FINANCIAL BALANCE OF PUB-
LIC SECTOR. WE WOULD APPRECIATE COMMENTS OR QUESTIONS
FROM WASHINGTON AND BONN IN TIME FOR REVIEW ON APRIL 16.
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7. FOR BONN: MISSION WELCOMES PARTICIPATION BY JURECKY
OF EMBASSY BONN AT ANNUAL REVIEW. HOTEL RESERVATIONS
MADE AT VICTOR-HUGO HOTEL, 19 RUE COPERNIC, PARIS 16
(TELEPHONE 553-76-01) FOR NIGHTS OF APRIL 15-16 INCLU-
SIVE. PLEASE CONFIRM THAT THESE ARRANGEMENTS ARE SATIS-
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